IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF TENNESSEE

In re QUALITY CARE AMBULANCE SERVICE, INC., 62-1474710; QUALITY TRANSPORTATION SERVICE, INC., 62-1483847; and QUALITY CARE OF EAST TENNESSEE, INC., 62-1629928, Debtors.	Nos. 00-22579 through 00-22581 Chapter 11
QUALITY TRANSPORTATION SERVICE, INC., Plaintiff, vs. PACIFIC CAPITAL, L.P., Defendant., -and- QUALITY CARE AMBULANCE SERVICE, INC. Plaintiff, vs. PACIFIC CAPITAL, L.P., Defendant.	Adv. Pro. No. 00-2062 Adv. Pro. No. 00-2063

M E M O R A N D U M

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MARCIA PHILLIPS PARSONS
UNITED STATES BANKRUPTCY JUDGE

In these consolidated adversary proceedings, the plaintiffs seek to avoid and recover certain alleged preferential payments made to the defendant, Pacific Capital, L.P. ("Pacific"). Presently before the court is Pacific's motion for summary judgment wherein Pacific asserts that because it is fully secured and the payments to it were distributions of its collateral, the plaintiffs will be unable to establish that the

payments enabled Pacific to receive more than it would in a chapter 7 as required by 11 U.S.C. § 547(b)(5).[1] As discussed below, the court agrees and will accordingly grant Pacific's motion for summary judgment.[2] This is a core proceeding. *See* 28 U.S.C. § 157(b)(2)(F).

I.

On September 27, 2000, Quality Transportation Service, Inc. ("QTS"), Quality Care Ambulance Service, Inc. ("QCAS"), and Quality Care of East Tennessee, Inc. each filed voluntary petitions under chapter 11 of the Bankruptcy Code. By order entered October 12, 2000, these cases were consolidated for administrative purposes. On November 20, 2000, two of the three debtors, QTS and QCAS, filed the complaints initiating these adversary proceedings, which proceedings were subsequently consolidated for discovery and trial by order entered January

[1]Pacific also asserts in its summary judgment motion that the payments to it were not preferential because the plaintiffs were not insolvent at the time of payment as required by 11 U.S.C. § 547(b)(3). The court having concluded that the 11 U.S.C. § 547(b)(5) issue is dispositive, it is not necessary for the court to determine the insolvency issue.

[2]Since the filing of the summary judgment motion, the plaintiffs have moved for leave to amend the complaints to add other causes of actions concerning the perfection of several motor vehicle liens, which motion was granted by order entered April 9, 2001. Accordingly, Pacific is only being granted partial summary judgment.

29, 2001. In the complaints, the plaintiffs allege that Pacific is an insider as defined by 11 U.S.C. § 101(31)(B)(iii) and (E) because it is a 30% equity holder in each of the plaintiffs. The complaints further set forth that Pacific holds a note dated July 19, 1996, in the original principal amount of $1 million executed by both plaintiffs. QTS alleges in its complaint that Pacific received $38,669.86 in payments from QTS within ninety days prior to its chapter 11 filing. In the other complaint, QCAS alleges that within one year prior to its chapter 11 filing, Pacific received $160,059.43 in payments from QCAS, including $139,725.89 paid in the ninety days immediately preceding the filing. Both complaints allege that these payments constitute "voidable preference[s] under 11 U.S.C. § 547."

In answer to both complaints, Pacific admits its ownership interest in the plaintiffs, but denies that it is an insider. Pacific also admits receipt of payments from the plaintiffs, but denies that the payments are avoidable as preferences under § 547 as Pacific contends that it was fully secured or oversecured and that the plaintiffs were solvent at the time the payments were made. In answer to the QCAS complaint, Pacific also asserts that those payments were made in the ordinary course of business.

On February 6, 2001, Pacific filed the motion for summary judgment which is presently before the court. In its supporting memorandum, Pacific states that on July 19, 1996, when it loaned the plaintiffs $1 million as evidenced by the promissory note, the plaintiffs granted Pacific a security interest in all of their "personal property, including general intangibles, accounts, chattel paper, instruments, documents and other property, including equipment and inventory." After the plaintiffs had defaulted in making the required monthly interest payments under the note, Pacific filed suit in state court in July 2000 to, *inter alia*, enforce its rights in its collateral. Pursuant to an agreed order which arose out of that litigation, the plaintiffs "were to commence the direction of certain collected accounts to Pacific." According to Pacific, "[m]ost of the funds at issue ... were collected by Pacific" pursuant to that order. As such, Pacific alleges that the payments to it were distributions of its collateral, i.e., the accounts receivable.

Pacific also claims that both at the time of the bankruptcy filing and throughout the preference period it was fully and in fact oversecured. Pacific contends that these facts negate a required element of a preference, that the payments enabled the creditor to receive more than it would have otherwise received

in a chapter 7 liquidation case. Pacific asserts that there is no dispute as to these material facts and therefore it is entitled to dismissal of the plaintiffs' preference claims as a matter of law. In evidentiary support of its motion, Pacific has submitted excerpts from the Fed. R. Bankr. P. 2004 examinations of Joseph Cerone and James Garner, principals of the plaintiffs; the plaintiffs' schedules and statements of financial affairs; and the affidavits of Larry Guyette, a former consultant for Pacific, Frederick L. Yocum, the chairman of Pacific's general partner, and David A. Jennings, a certified public accountant with Dent K. Burk Associates, P.C.

In response to Pacific's motion for summary judgment, the plaintiffs have submitted affidavits from Messrs. Cerone and Garner, which according to the plaintiffs create an issue of material fact precluding summary judgment. These affidavits, however, pertain primarily to the issue of insolvency and the control over the plaintiffs exercised by Pacific and do not address whether the alleged preferential payments allowed Pacific to receive more than it would have otherwise received in a chapter 7.

II.

In establishing a preference action under 11 U.S.C. § 547, "the trustee has the burden of proving the avoidability of a transfer under subsection (b)." 11 U.S.C. § 547(g). Subsection (b) of 11 U.S.C. § 547 states that:

> Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property—
> (1) to or for the benefit of a creditor;
> (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
> (3) made while the debtor was insolvent;
> (4) made—
> (A) on or within 90 days before the date of filing of the petition; or
> (B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
> (5) that enables such creditor to receive more than such creditor would receive if—
> (A) the case were a case under chapter 7 of this title;
> (B) the transfer had not been made; and
> (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

The Sixth Circuit Court of Appeals has observed that it "is facially evident from [§ 547(b) that] all five enumerated criteria must be satisfied before a trustee may avoid any transfer of property as a preference." *Waldschmidt v. Ranier (In re Fulghum Constr. Corp.),* 706 F.2d 171, 172 (6th Cir. 1983). *See also Still v. Fuller (In re Southwest Equip. Rental,*

Inc.), 1992 WL 684872, *19 (E.D. Tenn. 1992)("Unless the trustee proves each and every one of the elements listed in § 547(b)(1)-(5), the transfer ... will not be avoidable as a preference under § 547(b).”). Section 1107 of the Bankruptcy Code vests a debtor in possession in a chapter 11 case with the same rights and powers as a trustee. *See* 11 U.S.C. § 1107(a). Thus, in order to establish a *prima facie* case for their preference claims, the plaintiffs must be able to prove each element of § 547(b).

Without conceding all other elements of a preference, Pacific's summary judgment motion focuses upon the last required element of § 547(b)(5) which it contends the plaintiffs are unable to establish: that the transfers enabled Pacific to receive more than it would if this case were a chapter 7 case and the transfers had not been made. The treatise COLLIER ON BANKRUPTCY indicates that:

> Section 547(b)(5) is a central element of the preference section because it requires a comparison between what the creditor actually received and what it would have received under the chapter 7 distribution provisions of the Code. Specifically, the trustee must prove that the creditor received more than it would if the case were a chapter 7 liquidation case, the transfer had not been made, and the creditor received payment of the debt to the extent provided by the provisions of the Code.

5 COLLIER ON BANKRUPTCY ¶ 547.03[7] (15th ed. rev. 2001).

As previously noted, Pacific's first contention in this regard pertains to the status of the transfers as distributions of collateral. In *Paolella & Sons*, the district court noted that:

> [A] secured creditor in a Chapter 7 proceeding is entitled to receive its collateral or proceeds derived from its liquidation by the trustee. [Citation omitted.] Thus ... there is no preference under section 547(b) if the creditor merely receives a pre-petition transfer of its collateral or the proceeds therefrom, because the creditor has not received anything greater than it would have received in bankruptcy if the transfer had not been made.

Waslow v. MNC Commercial Corp. (In re M. Paolella & Sons, Inc.), 161 B.R. 107, 124 (E.D. Pa. 1993). More recently, the Fifth Circuit Court of Appeals recognized that:

> [T]he creditor will not be deemed to have received a greater percentage as a result of the payment if the source of the payment is the creditor's own collateral. A creditor who merely recovers its own collateral receives no more as a result than it would have received anyway had the funds been retained by the debtor, subject to the creditor's security interest.

Krafsur v. Scurlock Permian Corp. (Matter of El Paso Refinery, L.P.), 171 F.3d 249, 254-55 (5th Cir. 1999). Because all of the funds used to make the alleged preferential payments were proceeds of the creditor's collateral, the court in *El Paso Refinery* concluded that the creditor did not receive a greater percentage of recovery than it would have in a liquidation

proceeding and thus the trustee had failed to establish the fifth element of § 547(b). *Id.* at 258. *See also In re Datesman*, 1999 WL 608856, *10 n.17 (Bankr. E.D. Pa. 1999)(court observed that if a transfer had taken place during a preference period "it did not provide [the creditor] more than he would have received in a liquidation (i.e., his own collateral)"); WILLIAM L. NORTON, JR., 3 NORTON BANKRUPTCY LAW & PRACTICE 2D § 57:9 (2000)("[I]f a creditor with a valid security interest repossesses the collateral prior to bankruptcy, there is no preferential effect — he would have received the value of the collateral as part of the distribution in any event.").

In the affidavit of Frederick L. Yocum, the chairman of WP Pacific G.P., L.L.C., a general partner of Pacific, Mr. Yocum testifies based upon Pacific's business records that "[a]ll sums at issue in these cases are either sums directly collected from the Debtors' accounts receivable pursuant to [the state court agreed order], or are proceeds of the Debtors' accounts receivable collected at an earlier date." The affidavits submitted by the plaintiffs in response do not contradict this statement.

Furthermore, it appears undisputed that Pacific has a perfected security interest in the plaintiffs' accounts receivable and their proceeds. The plaintiffs' schedules list

Pacific as being a secured creditor with a lien on the accounts receivable and this obligation is not listed as disputed. Copies of the Loan and Security Agreement and the financing statements executed by the plaintiffs in connection with the loan from Pacific were attached to Pacific's proofs of claim filed in the plaintiffs' underlying bankruptcy cases and as exhibits to Mr. Yocum's affidavit. These documents likewise evidence a perfected security interest in the plaintiffs' accounts receivable and the proceeds therefrom. Accordingly, there is no genuine issue of material fact as to the assertion that Pacific has a perfected security interest in the plaintiffs' accounts receivable and that the alleged preferential payments to Pacific were distributions of this collateral. As such, the plaintiffs will be unable to establish that the transfers to Pacific enabled it to receive more than it otherwise would in a chapter 7 case.

Similarly, Pacific's second basis for summary judgment is meritorious. Pacific maintains that because it is a fully and in fact oversecured creditor, it did not receive more than it would have otherwise received if this were a chapter 7 case. The treatise NORTON BANKRUPTCY LAW & PRACTICE explains:

> If the secured creditor's lien is valid in bankruptcy, his expected return in a bankruptcy liquidation includes the value of the collateral up to the total amount of the claim. If the value of the collateral

> exceeds the debt, the creditor's position is not improved by any payment on account of the debt.

WILLIAM L. NORTON, JR., 3 NORTON BANKRUPTCY LAW & PRACTICE 2D § 57:9 (2000).

The Sixth Circuit Court of Appeals has adopted this well-recognized analysis. In its 1990 decision in *C-L Cartgage,* the Sixth Circuit Court of Appeals stated that "[p]ayments to a creditor who is fully secured are not preferential since the creditor would receive payment up to the full value of [its] collateral in a Chapter 7 liquidation." *Ray v. City Bank and Trust Co. (In re C-L Cartage, Co., Inc.)*, 899 F.2d 1490, 1493 (6th Cir. 1990). Earlier this year, the Sixth Circuit reiterated this conclusion, holding that payments to a fully secured bank in satisfaction of its security interest were not preferential because the bank "would receive the same amount in a chapter 7 bankruptcy ...." *First Tennessee Bank v. Stevenson (In re Cannon*), 237 F.3d 716, 717 (6th Cir. 2001). *See also Matter of El Paso Refinery, L.P.*, 171 F.3d at 253 ("a fully secured creditor who receives a prepetition payment does not receive a greater percentage than he would have in a bankruptcy proceeding because as a fully secured creditor he would have recovered 100% payment in a bankruptcy proceeding"); *Bruinsma v. Citizens Banking Corp. (In re Fleming)*, 226 B.R. 3, 7 (Bankr. W.D. Mich. 1998) ("It is well-settled that payments made to

fully-secured or oversecured creditors are not avoidable as preferences."); *Still v. Congress Fin. Corp. (In re Southwest Equip. Rental, Inc.)*, 137 B.R. 263, 269 (Bankr. E.D. Tenn. 1992)(if a debt is fully secured or oversecured there would be no improvement in position).

The appropriate date for making a liquidation analysis under § 547(b)(5) is the date of the bankruptcy filing. *See Still v. Rossville Bank (In re Chattanooga Wholesale Antiques, Inc.)*, 930 F.2d 458, 465 (6th Cir. 1991); *Taunt v. Fidelity Bank of Michigan (In re Royal Golf Products Corp.)*, 908 F.2d 91, 95 (6th Cir. 1990); *Neuger v. U.S. (In re Tenna Corp.)*, 801 F.2d 819 (6th Cir. 1986). Therefore, if Pacific was in fact fully secured on the date of the plaintiffs' bankruptcy filing as it contends, then it is correct that the payments to it were not preferential.

Pacific has filed proofs of claim in the plaintiffs' underlying bankruptcy cases indicating that it was owed the sum of $1,079,974.39 by the plaintiffs as of the date of the bankruptcy filing.[3] The proofs of claim further indicate that

[3]The plaintiffs' schedules list the obligation to Pacific as $950,932.10 while the plaintiffs' cash collateral motion indicated that the debt owing to Pacific was $928,109. These differences are not relevant to the motion which is before the court.

Pacific asserts a security interest not only in the plaintiffs' accounts receivable, but also "generally all personal property" of the plaintiffs and that this collateral has a total value of $5,421,081.84. The Loan and Security Agreement and the financing statements executed by the plaintiffs in connection with the loan from Pacific appear to support Pacific's assertion that it has a security interest in all of the plaintiffs' personalty. Nothing has been filed in these adversary proceedings or the bankruptcy cases themselves challenging the existence or the scope of Pacific's security interest,[4] although the schedules filed by the plaintiffs indicate only a security interest by Pacific in the accounts receivable with a scheduled combined "estimated net collectible value" in both of

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[4]In the affidavit of James Garner, controller for the plaintiffs, Mr. Garner states in paragraph 9 that "[i]n reviewing information with counsel for the companies, counsel has indicated that certain of the security interest claims by Pacific Capital, L.P. are questionable." The court attaches no significance to this statement because it is not based on personal knowledge of the affiant and because it fails to set forth any factual or legal basis for his conclusion. *See* Fed. R. Civ. P. 56(e), incorporated by Fed. R. Bankr. P. 7056.

In their amended complaint, the plaintiffs maintain that within 90 days of the bankruptcy filing, Pacific obtained liens upon various motor vehicles of the plaintiffs, including vehicles totaling $75,000 owned by QCAS and vehicles worth $86,000 owned by QTS. The plaintiffs do not seek to avoid or set aside these liens although they do seek these amounts in damages from Pacific. Accordingly, the court will exclude the value of these vehicles in its determination of whether Pacific is fully secured.

plaintiffs' cases of $1,524,882,81. Total personalty property in both cases is listed at $5,421,081.84.

In a motion filed by the plaintiffs on October 2, 2000, for the use of cash collateral, the plaintiffs noted that Pacific claims a security interest in the plaintiffs' accounts receivable and the proceeds thereof and asserted that this security interest was oversecured. As stated by the plaintiffs in paragraphs 10, 11 and 13 of the motion:

> The Debtors would show that they had on the Petition Date accounts receivable in the amount of $4,091,652.00. In addition, Pacific Capital, L.P. is also claiming liens on other assets of the Debtors which liens if valid would have a value in excess $1,000,000.00.
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> Debtor [sic] would show that a large percentage of the above mentioned receivables would be collectible, in particularly the receivables which the federal and state governments have been historically paying late under it's [sic] medical payment provisions in the amount of approximately $1,500,000.00 which should be totally collectible.
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> ...
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> The debtors believe that their current accounts receivable has a value much in excess of that necessary to adequately protect the interest of Pacific Capital, L.P. In addition, Pacific Capital, L.P. is claiming liens on other property adequate to protect it's [sic] interest.

In the Rule 2004 examination conducted on December 1, 2000, of Joseph Cerone, CEO for both plaintiffs, Mr. Cerone affirmed that

the factual allegations contained in the motion were correct to the best of his knowledge and belief.

Additional evidence submitted by Pacific in support of its summary judgment motion establish that it was oversecured. James Garner, the controller for the plaintiffs, opined in his Rule 2004 examination that there was enough accounts receivable to cover Pacific's loan. In the affidavit of David Jennings, a certified public accountant retained by Pacific, Mr. Jennings states that "the value of the assets subject to the security interest of Pacific Capital was, at the time of the filing of the Petitions on September 27, 2000, in excess of (i) the indebtedness owed to Pacific Capital and (ii) the indebtedness owed to all secured creditors, including the holders of the Tax Liens."[5] In support of this proposition, Mr. Jennings attaches an Exhibit B prepared by him which lists the plaintiffs' total assets subject to liens at a value of $4,763,472.17 and total secured liabilities including Pacific at $3,436,995.01. Also attached is Exhibit C which indicates that the assets of QCAS alone which are subject to liens were more than sufficient on

[5]The plaintiffs assert that Pacific's lien may be "primed" by an IRS lien in the amount of $1,175,354.94. Mr. Jennings' affidavit and exhibits establish that Pacific has ample collateral such that even if the IRS lien does "prime" Pacific's lien, Pacific remains fully secured.

the date of its bankruptcy filing to satisfy its secured liabilities, i.e., $3,464,485.66 to $2,381,981.41.

The affidavits of Messrs. Cerone and Garner submitted by the plaintiffs in opposition to Pacific's summary judgment motion do not contradict this evidence. Mr. Cerone's affidavit addresses the control exercised over the plaintiffs by Pacific and how Pacific's collection efforts led to the bankruptcy filings. Mr. Garner makes similar statements in his affidavit and additionally makes certain representations regarding the solvency of the plaintiffs, noting that if all three debtors were considered, total liabilities exceed total assets. However, the issue of the plaintiffs' insolvency is not determinative of whether Pacific was fully secured. The former requires a consideration of all liabilities and assets of the plaintiffs while the latter involves only Pacific's collateral and the debts secured thereby. Accordingly, the affidavits of Messrs. Cerone and Garner are not relevant on the issue of whether Pacific is fully secured. Based upon the foregoing, the court concludes that Pacific was fully secured and as such, the plaintiffs will be unable to establish that Pacific received more than it otherwise would have if this were a chapter 7 case as required by 11 U.S.C. § 547(b)(5).

III.

The Sixth Circuit Court of Appeals has stated that "[s]ummary judgment is appropriate if the plaintiffs have failed to make a showing sufficient to establish an element essential to their claims and on which they bear the burden of proof." *Wallace v. Bank of Bartlett*, 55 F.3d 1166, 1167 (6th Cir. 1995). Because the plaintiffs have failed to prove an "essential element" for which they bear the burden of proof, summary judgment in Pacific's favor is appropriate on the original claims in the complaints. An order will be entered contemporaneously with the filing of this memorandum opinion granting Pacific's motion for summary judgment.

FILED: April 16, 2001

BY THE COURT

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MARCIA PHILLIPS PARSONS
UNITED STATES BANKRUPTCY JUDGE